BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
	)	
Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation	)	MM Docket No. 93-215
	)	
and	)	
	)	
Adoption of a Uniform Accounting System for Provision of Regulated Cable Service	)	CS Docket No. 94-28

MEDIA GENERAL'S REQUEST FOR RECONSIDERATION

Media General Cable of Fairfax County, Inc. ("Media General") request that the Commission reconsider two elements of the Report and Order and Further Notice of Proposed Rulemaking in this docket released March 30, 1994 ("Cost-of-Service Order").

The first issue as to which we ask the Commission to re-think its position is narrow in scope. The reconsideration relief that we request on this issue is narrower still; it will have application to very few cable systems. The relief offered in the Cost-of-Service Order for systems that have incurred substantial legitimate accumulated start-up losses is insufficient for systems, such as Media General, for which the FASB 51 prematurity period provides an inadequate conceptual framework for measuring operating losses. For the reasons set out below, systems that fall into this narrow category should be permitted to recover additional operating losses.

The second issue as to which we seek reconsideration, the offset of advertising revenue, is of broader importance to the industry and the public served by it. Form 1220 provides for a result that was, at best, obliquely intimated in the Rate Order,[1/] 8 FCC Rcd at 5602, n.602. Advertising revenues received by cable operators for programming carried in both the basic and cable programming service tiers will be offset against costs in the cost-of-service methodology. As we demonstrate below, this result is not compelled by statute and, at least in application to the cable programming service tiers, is contrary to the Commission's espoused desire to provide incentives for maximizing diversity in cable programming service offerings.

In At Least Some Circumstances, A Broader Recovery of Start-Up Losses Than That Provided for in the Cost-of-Service Order Should Be Permitted

Having vigorously argued for it, Media General applauds the Commission's conclusion that "... some accumulated start-up losses, to the extent that they reflect operating losses in the early years of the system, should be included in the rate base." Cost-of-Service Order, slip op. at 37, paragraph 70. We disagree with the Commission's standard for

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[1/] Implementation of Sections of the Cable Television Consumer Protection of Competition Act of 1992, Rate Regulation, MM Docket No. 92-266, Report and Order and Further Notice of Proposed Rulemaking, 8 FCC Rcd 5631 (1993).

implementing this principle, at least as it would work in application to Media General. The Commission limited the start-up losses for which recovery will be permitted as follows:

> We therefore allow recovery in the ratebase of accumulated start-up losses that are equal to the lesser of the first two years of operating costs or accumulated losses incurred until the system reaches the end of its prematurity stage as defined by FASB 51.

Id., slip op. at 38, paragraph 71 (footnote omitted).[2/] We submit that this formulation credits FASB 51 with factual conclusions not intended by that standard. Even were the significant factual conclusions read into FASB 51 fairly attributed to the Board's pronouncement, it would be inappropriate for the Commission to give to this accounting standard the presumptive force that it has.[3/]

FASB 51, like all of the standards promulgated by the Financial Accounting Standards Board is, understandably enough,

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2/ There is an additional narrow problem with this formulation. The FASB standard has an imbedded presumption that the prematurity period will last no more than two years. This presumption is rebuttable, at least for systems "in major urban markets." FAS 51.04. To the extent that this presumption is the source of the Commission's invocation of "the first two years of operating losses...", we suggest that the agency has misunderstood the operation of the accounting standard. If the genesis of this clause is elsewhere, the source and logic is nowhere explained.

3/ We appreciate that adaptation of the FASB 51 standard is only presumptively determinative of allowable start-up losses. We nonetheless urge that the presumption should be removed both because it unfairly burdens a deserving operator's power to recoup legitimate start-up losses and because, as we explain in what follows, the FASB 51 standard was not designed and is not suited to serve as an instrument of rate regulation.

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an accounting rule. It draws a line[4] across the early life-span of cable systems to determine when (and which) start-up costs should be capitalized. It also provides standards for determining when properly capitalized start-up costs should be written off as unrecoverable. FAS 51.14. What it does not do and, as an accounting rule, does not have the jurisdictional authority to do, is to determine whether (or when) cable operators may recover expensed start-up costs from the post-prematurity period. The Commission has outpaced the purport and purpose of FASB 51 by ceding to it this latter significance.

The Commission has indicated its belief that FASB 51 "... suggests that a two-year period is a reasonable and representative startup time for cable systems." Cost-of-Service Order, slip op. at 37-38, paragraph 71. There is not a word of support for this conclusion in FAS 51 or in the Glossary (Appendix A) or Commentary (Appendix B) that accompany it. The Accounting Standards Board explains its rationale for the accounting standards pronounced in FASB 51; it nowhere hints that the end of the prematurity period ought to represent a break-even point for cable operators, the conclusion that the FCC apparently believes the standard to represent.

4/ More accurately, the accounting standard creates rules to govern this line drawing by cable system officers and/or accountants.

We submit that such an accounting standard simply cannot, in this case, serve as a surrogate for reasoned principles of rate regulation. We do not mean to suggest by this that the Commission has gotten the principles wrong. To the contrary, we think that the general standard for the recovery of accumulated start-up losses that the Commission has announced is exactly right:

> We conclude that some accumulated start-up losses, to the extent that they reflect operating losses in the early years of the system, should be included in the ratebase. These losses could be considered to meet the used and useful standard in that it is frequently necessary for businesses during a start-up phase to sustain a period of losses prior to profitability. As such, the losses benefit customers because it is necessary for the operator to incur them in order to bring future service to subscribers.

Cost-of-Service Order, slip op. at 37, paragraph 70. It is only the Commission's reliance on FASB 51 as a presumptively correct measure to implement this policy that is erroneous.

The obvious problem in application of the general principles articulated by the Commission is in distinguishing early year losses that are appropriately recovered in later years from those that are not. We suggest that the logical first step in making this distinction is to examine what caused the losses.

In the case of Media General, the early losses were caused by a convergence of three factors. The first of these was a very significant miscalculation of the extent of plant that would be required to build out Media General's primary service area ("PSA"). In studies developed by CTIC Associates for the County of Fairfax, a plan demarcating the primary service area for the system in Fairfax County indicated that just over 2,000 total system miles would be required to serve the PSA. As Media General began construction of the PSA plant, it discovered that slightly more than 3,100 total system miles--an increase of 55 percent with attendant cost increases--would be required to serve the PSA.

Media General could have seized on this significant plant mileage error in the County's pre-bid representations to extract concessions from its local franchise authorities. It did not do this; it built the system that it had committed to build, even though the undertaking was substantially more economically onerous than expected.

This extra expense was not accounted for in the rates that Media General had projected as necessary in early years. Worse, Media General had made a commitment to its local franchising authorities that it would not raise its rates for four years. With the passage of the 1984 Cable Act, this promise could probably have been circumvented. It was not; Media General kept its rates at the initially promised levels for the first four years of system operation.

Even when it first raised rates at the end of the four year freeze period, in 1987 Media General did not set its new rates at levels that were fully compensatory. The rationale for this was two-fold. First, Media General was concerned that the level of price increases necessary to equalize then-current costs and revenues would have sufficiently suppressed demand to have resulted in even greater operating losses than those that would result from the still non-compensatory rates that it adopted. Second, Media General was under strong pressure from its local franchising authorities not to raise rates too sharply. The local authorities did not, of course, have the legal power to constrain rate increases. Nonetheless, Media General was persuaded to respect the views of its local regulators. Accordingly, Media General believed that increasing penetration and encouraging the purchase of additional services by slowly increasing rates in phases represented sound business judgment as well as prudent public relations. Media General continued this pattern of phased price increases until it reached a breakeven point in 1991--eight years after the initiation of construction.

We suspect that one of the reasons the Commission is proceeding very, very cautiously in permitting the recoupment of start-up losses is the persuasion that pre-1992 Cable Act rates were constrained only by market forces. That is, where cable operators could, they freely reaped monopoly profits and refrained from that practice only where market forces intervened. That logic supports the conclusion that regulated rates should never be higher than pre-regulation rates because the purpose of regulation is to emulate competitive market conditions. The history that we have recited above establishes that this line of reasoning cannot be applied too broadly. It is true enough that cable systems were not earlier subject to rate regulation, but they were subject to a broad skein of local regulation that permitted local franchising authorities to influence rate levels.

The Commission's logic of revenue maximization also attributes to cable operators a spirit of short-run avarice that is belied by the history of Media General's operation. Media General could have increased its revenue in earlier days by leveraging on the error made by the franchising authority in estimating the extent of construction that would be required to serve that jurisdiction's primary service area. It could also have increased its revenues by repudiating its commitments concerning early year rate stability made to franchising authorities, or by subjecting subscribers to dramatic rate increases once rate stability promises had been honored. It did none of these things, not because competitive market forces precluded their accomplishment but because Media General had adopted a longer run perspective. Such a reasonable business judgment made years ago in a largely unregulated environment ought not now to be second-guessed and indeed penalized through the imposition of an inapposite accounting standard as a critical rate determinant.

The <u>Cost-of-Service Order</u> is absolutely right in concluding that there must be a mechanism in cost-of-service proceedings to permit cable companies to recover reasonable and legitimate start-up losses. But, the Commission has erred conceptually in presuming that an accounting standard may be used as a test of reasonable and legitimate start-up losses. FASB 51 was not designed to measure losses properly recoverable under a regime of cost-of-service rate regulation and, not surprisingly, it is not a rational measure of defining properly recoverable start-up losses.

The presumption that only prematurity period operating losses may be included in cost-of-service ratebase calculations should be removed. All reasonably incurred start-up losses should be considered in cost-of-service showings.

The Treatment of Advertising Revenues, Required by Form 1220 is Inconsistent with the Act and its Purposes

Form 1220 requires cable operators to offset operating expenses by an amount equal to "the revenues earned for cable advertising operations." Instructions for Completion of Cost-of-Service Filing For Regulated Cable Services (Form 1220) at page 14. This required adjustment is nowhere discussed in the text of the Cost-of-Service Order and seemingly derives from an oblique and, in any event cursory, reference to advertising revenues contained in the Rate Order, 8 F.C.C. Rcd at 5602, n.602. Media General maintains that, if this requirement is to be adhered to at all, it (i) must be modified to conform with the treatment of offsets that the Commission has established for external costs (see Letter of Clarification to QVC Network, Inc., released May 9, 1994) and (ii) should be limited to advertising revenues associated with program services carried in the basic tier.

A change must be made to Form 1220 in order to conform it with the principles underlying the Commission's recently released letters to QVC Network, Inc., and the Home Shopping Network. See Letter of Clarification to QVC, Inc., released May 9, 1994; Letter of Clarification to Home Shopping Network, released May 9, 1994. In these letters, the Commission has recognized, albeit only in the context of external cost adjustments, that the literal application of a revenue offset to expenses goes further than is required to protect subscriber interests. It said that "the purposes of the rule will be fully achieved if offset requirements are applied on a channel-by-channel basis." That same conclusion obtains with respect to the application of the offset requirements under the cost-of-service showing rules and Form 1220. As in the case of external cost adjustments, the application of the offset requirement in the cost-of-service context on a channel-by-channel basis will, at least, represent a very small step in the direction of a rule which "fairly balances" the interests of cable operators, program service providers and subscribers. Letter of Clarification to QVC, Inc., at page 2.

There are, moreover, compelling reasons of policy to apply the offset of advertising revenues against cost only with respect to program services in the basic tier. In its development of the full reduction rate and going forward formula, the Commission has not required any rate adjustment based on advertising revenues. See, 76.922(b); 76.922(d)(3)(x). Assuming there is some valid reason to treat advertising revenues in cost-of-service showings differently than in benchmark justifications--a distinction which we find tenuous--it is, in any event, clear that the Commission is not legally compelled to adopt rules requiring offsets in all regulated tiers. It may not be inappropriate to "count" advertising revenues against subscriber rates in order to "help keep basic tier rates low." H.R. Conf. Rep. 102-862 at 63 (emphasis added). But, in the context of cable programming services rates, where the Commission is "authorized" but not required to consider advertising revenues (H.R. Conf. Rep. 102-862 at 65), a rule which "fairly balances" the competing interests requires a different result so that other, overriding policy goals can be met. Letter of Clarification to QVC, Inc. at page 2.

The Congress has repeatedly stressed, and the Commission has consistently recognized, that the rate regulation formula must be constructed to "ensure that cable operators continue to expand, where economically justified, their capacity and the programs offered over the cable systems." P.L. 102-385 § 2(b)(3). The requirement that advertising revenues derived from services carried in the cable programming services tier be offset against operating expenses will interfere with attainment of this goal: Cable operators that anticipate the need to defend rates on the basis of future cost-of-service showings will be dissuaded from adding new programming services to regulated tiers. This problem will be particularly acute in the case of new programming services that carry a relatively modest per subscriber fee but hold significant potential for the realization of advertising revenues. A cable operator adding such a service to a system will be forced either to artificially (and economically irrationally) constrain the amount of advertising revenues that it will accept with respect to the new service, face the possibility that advertising revenue from the new service will produce a zero return on the cost which the cable operator must incur to add the service to a regulated tier, or decline to add the service.

It does not serve any public policy objective to discourage cable operators from adding new program services or from competing vigorously in the highly competitive television advertising market. Simply put, the offset of advertising revenues against operating expenses associated with the cable programming service tier will delay and possibly thwart the deployment of digital compression technologies. It will deny the American public the full measure of program diversity that cable television can offer.

In the context of price cap rate increases, the Commission has recognized that there is a need to build into the methodology adequate incentives to encourage cable operators to add new services to their regulated tiers. See Sections 76.922(d)(3)(xi); 76.922(e). Whether these new standards will achieve the intended goal of fostering diversity through the launch of new program services remains unclear; but the mechanism is plainly designed to afford cable operators an entrepreneurial incentive to add services to regulated tiers. The policy of promoting the launch of new services is not, or surely ought not to be, dependent upon the particular formula that a cable operator uses to justify its rates. For the very same reasons that led the Commission to the adoption of Sections 76.922(d)(3)(xi) and (e), there is need for an entrepreneurial incentive in the context of the cost-of-service formula. The treatment of advertising revenues "below-the-line," at least in regulated tiers where Congress did not command these revenues to be considered in the determination of subscriber rates, creates that incentive.

For these reasons, Media General submits that the inadequately considered requirement that cable operators offset advertising revenues against operating costs in all regulated tiers will undermine public interest objectives that the Congress has mandated the Commission to take into account in its development of rate regulation. If advertising revenues are to be applied as an offset against operating expenses at all, this should occur only with respect to program services carried in the basic tier and should be applied on a channel-by-channel basis.

Respectfully submitted,

Ian D. Volner
N. Frank Wiggins
Venable, Baetjer, Howard
& Civiletti
1201 New York Avenue, N.W.
Washington, DC 20005

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